Supreme Court, U.S.
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Nos. 03-1581, 03-1583, 04-181

In The
Supreme Court of the United States

KNIGHT-RIDDER, INC.,
Petitioner,

v.

CAPITAL FACTORS, INC., *et al.*,
Respondents.

HANDLEMAN COMPANY,
Petitioner,

v.

CAPITAL FACTORS, INC., *et al.*,
Respondents.

IRVING PULP & PAPER, LIMITED, dba IRVING PAPER,
Petitioner,

v.

CAPITAL FACTORS, INC., *et al.*,
Respondents.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF IN OPPOSITION OF CAPITAL FACTORS, INC.

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CORPORATE DISCLOSURE STATEMENT PURSUANT TO SUPREME COURT RULE 29.6

Respondent Capital Factors, Inc. ("Capital") hereby represents that (i) Capital Factors Holding, Inc. ("Capital Holding") is Capital's parent company; (ii) Regions Financial Corporation, a publicly held corporation, is Capital Holding's parent company; and (iii) no other publicly held company owns 10 percent or more of Capital's stock.

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BRIEF IN OPPOSITION

This is Capital's consolidated response in opposition to the petitions ("Petitions") of Knight-Ridder, Inc. ("Knight-Ridder"), Handleman Company ("Handleman"), and Irving Pulp & Paper, Limited ("Irving") for a writ of certiorari to review the decision ("Decision") of the U.S. Court of Appeals for the Seventh Circuit ("Seventh Circuit") in *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004). For the reasons set forth below, the Petitions should be denied.

INTRODUCTION

Through the Decision, the Seventh Circuit affirmed the reversal of a "critical-vendors" order in the chapter 11 bankruptcy case of Kmart Corporation ("Kmart"). The critical-vendors order gave Kmart open-ended authority, on the first day of its bankruptcy case, to pay the prepetition debts of certain suppliers it deemed "critical" in the exercise of its unilateral discretion. *Kmart*, 359 F.3d at 868-69. Kmart fully paid the prepetition debts of approximately 2330 suppliers. *Id.* In contrast to those suppliers, which collectively received about $300 million, Kmart's remaining unsecured creditors eventually received about 10¢ on the dollar on account of their claims, mostly in the form of reorganized Kmart stock. *Id.*

Under the authority of the critical-vendors order, Kmart paid in full the prepetition claims of Knight-Ridder, Handleman, and Irving (collectively, the "Petitioners"). However, the district court subsequently reversed the critical-vendors order. Facing potential liability for the recovery of those now-unauthorized payments from Kmart in pending adversary proceedings brought under § 549 of

the Bankruptcy Code,[1] the Petitioners seek this Court's review of the Seventh Circuit's Decision to affirm the reversal of the critical-vendors order.

The Petitions[2] articulate no compelling reason for granting certiorari in accordance with Sup. Ct. R. 10. As described below, they take liberties with the record, distort the Decision, and rely on inapposite authorities. The Petitions should be denied for the following reasons:

- Though Knight-Ridder takes issue with the Seventh Circuit's application of § 363(b) to the critical-vendors order, its Petition fails to demonstrate any inconsistency between the Seventh Circuit's analysis and those of other circuit courts that have applied § 363(b) in different contexts. Moreover, as the Seventh Circuit stated, "[w]e need not decide whether § 363(b)(1) could support payment of some pre-petition debts, because *this* order was unsound no matter how one reads § 363(b)(1)." *Kmart*, 359 F.3d at 872.

- Notwithstanding Handleman's contentions to the contrary, neither the critical-vendors order nor the district court's subsequent reversal of that order was an *in personam* judgment against Handleman. They were *in rem* orders. Handleman's Petition proceeds from a fundamental misunderstanding of the *in rem* nature of bankruptcy jurisdiction, and it ignores the Seventh Circuit's reliance

[1] Unless otherwise indicated, all statutory references relate to the U.S. Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.* (2004).

[2] References to the Petitions of Knight-Ridder, Handleman and Irving are cited as "KP," "HP," and "IP," respectively.

on Fed. R. Bankr. P. 8001 for the rejection of Handleman's due process arguments. Handleman's quarrels with the Seventh Circuit's admonitions and dicta are no grounds for granting certiorari.

- Irving's Petition seeks an advisory opinion on a circuit split over the proper application of the mootness provisions of § 364(e). Regardless of whether the circuits are split, that issue is inapplicable to this case because the bankruptcy court did not authorize the critical-vendors order under § 364. Even if § 364(e) was applicable, no evidence was presented below to sustain a finding that Irving had acted as a "good faith" lender entitled to the protections of § 364(e).

REASONS FOR DENYING THE PETITIONS

I. Notwithstanding Knight-Ridder's Contention To The Contrary, The Seventh Circuit's Analysis Of § 363(b) Was Consistent With *Lionel* And Its Progeny.

Knight-Ridder contends that the Seventh Circuit's analysis of § 363(b) deviated from "the accepted judicial standard of section 363(b) approval." (KP at 2, 6-9.) In support of this contention, Knight-Ridder cites *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063 (2d Cir. 1983) and its progeny. (KP at 6-8.)

Contrary to Knight-Ridder's contention, the Decision reflects a comparable analysis and rationale to that of *Lionel*. Like the Decision, *Lionel* instructs bankruptcy courts "to articulate sound business justifications for

[their] decisions," and "to further the diverse interests of the debtor, creditors and equity holders, alike," rather than "blindly follow[ing] the hue and cry of the most vocal special interest groups." *See Lionel*, 722 F.2d at 1066, 1071. Rather than demonstrating the Seventh Circuit's deviation from established standards for appellate review of § 363(b) orders, *Lionel* actually shows the Seventh Circuit's consistency.

In *Lionel*, the U.S. Court of Appeals for the Second Circuit ("Second Circuit") reviewed, and ultimately reversed, a bankruptcy court's order authorizing a chapter 11 debtor to sell its primary asset before a plan of reorganization could be considered. *Id.* at 1065. In confirming the sale, the bankruptcy court made no formal findings of fact; it "simply noted that cause to sell was sufficiently shown by the Creditors' Committee's insistence upon it." *Id.*

Concerned that an overbroad construction of § 363(b) "swallows up Chapter 11's safeguards" such as plan disclosure and voting requirements, the Second Circuit "reject[ed] the view that § 363(b) grants the bankruptcy judge *carte blanche*." *Id.* at 1069. Instead, the Second Circuit instructed bankruptcy judges determining § 363(b) requests to make express findings from the evidence presented before them that there is "some articulated business justification, other than appeasement of major creditors, for using, selling or leasing property out of the ordinary course of business before the bankruptcy judge may order such disposition under section 363(b)." *Id.* at 1070-71. In fashioning its findings, a bankruptcy judge "should consider all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors and equity holders, alike."

Id. at 1071. Mere creditor appeasement was "insufficient as a matter of fact because it is not a sound business reason and insufficient as a matter of law because it ignores the equity interests required to be weighed and considered under Chapter 11." *Id.*

As Knight-Ridder points out, other circuit courts have adopted the *Lionel* approach to § 363(b). *See, e.g.*, *Stephens Indus., Inc. v. McClung*, 789 F.2d 386, 390 (6th Cir. 1986); *Institutional Creditors of Cont'l Airlines, Inc. v. Cont'l Airlines, Inc. (In re Cont'l Airlines, Inc.)*, 780 F.2d 1223, 1226 (5th Cir. 1986). Though the Seventh Circuit ultimately determined that "[w]e need not decide whether § 363(b)(1) could support payment of some pre-petition debts, because *this* order was unsound no matter how one reads § 363(b)(1)," its approach in the Decision was also similar to that of the Second Circuit in *Lionel*. *Kmart*, 359 F.3d at 872-74. The Seventh Circuit reviewed the "scant record" for evidence that could justify the purported reasons for the critical-vendors order, and, like the Second Circuit in *Lionel*, it did not consider the appeasement of a vocal special interest group to be an appropriate basis for approval under § 363(b). *Id.*

As the Seventh Circuit noted, "[t]he foundation of a critical-vendors order is the belief that vendors not paid for prior deliveries will refuse to make new ones." *Kmart*, 359 F.3d at 872. For that premise to hold true, a showing must be made that "supposedly critical vendors would have ceased deliveries if old debts were left unpaid." *Id.* at 873. However, the bankruptcy court "did not find that any firm would have ceased doing business with Kmart if not paid for pre-petition deliveries, and the scant record would not have supported such a finding had one been made." *Id.* at 874. In other words, neither the debtor nor the bankruptcy

court articulated a valid reason for the entry of the critical-vendors order.[3]

Moreover, the Seventh Circuit found that a critical-vendors order could not stand under § 363(b) unless it is supported by a showing that disfavored creditors are either likely to receive a benefit or will be no worse off from the requested payments. *Id.* at 873-74. The weighing and consideration of disparate interests in the context of a § 363(b) request is consistent with the approach taken in *Lionel*. *Lionel*, 722 F.2d at 1071 ("In fashioning its findings [on a § 363(b) application], a bankruptcy judge must . . . act to further the diverse interests of the debtor, creditors and equityholders, alike."). Since the record provided no such showing, the Seventh Circuit, like the Second Circuit in *Lionel*, could not allow the bankruptcy court's order to stand. *See Kmart*, 359 F.3d at 874.

As *Lionel* and the Decision both instruct, bankruptcy courts should not serve as a rubber stamp of the debtor's business judgment when they are presented with a § 363(b) request. They must insist on an articulation of that judgment and make express findings to that effect from the evidence presented before them. They must also ensure that vocal special interest groups are not unduly swaying the course of the bankruptcy case at the expense of other competing interests.

For the foregoing reasons, Knight-Ridder has failed to show that the Decision deviated from any established

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[3] As the bankruptcy court itself noted, "[m]otions to pay critical trade creditors always present difficult questions for courts. We're seeing more and more of them, and our problem is that we have to stretch to find some authority to do them." (KP at 66a.)

standard of appellate oversight on § 363(b) issues. Its Petition should be denied accordingly.[4]

II. Handleman Ignores The Seventh Circuit's Holding And Focuses Upon Its Dicta.

A. The Handleman Petition reflects a fundamental misunderstanding of the *in rem* nature of the critical-vendors order and the district court's reversal of that order.

The Handleman Petition rests on an erroneous premise – that the reversal of the critical-vendors order was an *in personam* judgment against Handleman. (HP at 12-14.) As the Seventh Circuit concluded, however, the critical-vendors order concerned Kmart and the use of its property, and it created no rights or interests in favor of anyone but Kmart. *See Kmart,* 359 F.3d at 870. Just as the critical-vendors order was not an *in personam* judgment for or against Handleman or any other creditor, neither was its reversal by the district court. Both were exercises of *in*

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[4] Knight-Ridder also contends that the Decision conflicted with this Court's decision in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 525 (1984). (KP at 8-10.) The *Bildisco* case dealt with the rejection of a collective bargaining agreement under § 365, an issue and a section of the Bankruptcy Code that are not applicable to this case. *See Bildisco*, 465 U.S. at 516. Nevertheless, Knight-Ridder contends that the Decision conflicts with this Court's endorsement of the "policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code." *Id.* at 525. For the same reasons that the Decision is consistent with *Lionel*, as stated above, it is also consistent with this Court's reasoning in *Bildisco* and its corresponding concern that bankruptcy courts balance the "multiple, competing considerations underlying a Chapter 11 reorganization" through a "reasoned finding on the record" why chapter 11 policy will be served by the requested action. *See id.* at 526-27.

rem jurisdiction over Kmart and its property; personal jurisdiction over Handleman is irrelevant.

Bankruptcy courts have exclusive jurisdiction over a debtor's property, wherever located, and over the bankruptcy estate. *See* 28 U.S.C. § 1334(e). Because the exercise of that jurisdiction is premised on the debtor and its estate, and not on the creditors, bankruptcy courts are able to enter binding orders through their *in rem* jurisdiction without the necessity of acquiring *in personam* jurisdiction over any particular creditors. *Tenn. Student Assistance Corp. v. Hood*, 124 S. Ct. 1905, 1911, 1914 (2004) (citing 4A C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1070 at 280-81 (3d ed. 2002) (noting jurisdiction over the person is irrelevant if the court has jurisdiction over the property)). Indeed, "[a] bankruptcy court's *in rem* jurisdiction permits it to 'determin[e] all claims that anyone, whether named in the action or not, has to the property or thing in question. The proceeding is "one against the world."'" *Id.* at 1911 (quoting 16 J. MOORE, *ET AL.*, MOORE'S FEDERAL PRACTICE § 108.70[1] at 108-106 (3d ed. 2004)); *see also Local Loan v. Hunt*, 292 U.S. 234, 241 (1934) ("generally, proceedings in bankruptcy are in the nature of proceedings *in rem*").

The critical-vendors order was an exercise of the bankruptcy court's *in rem* jurisdiction over Kmart and its property. As such, it was binding on all Kmart creditors, whether or not they received notice or participated in the bankruptcy court's hearing on the matter. Though the critical-vendors order mentioned Handleman, it gave no relief of any sort to Handleman or any other vendor. (*See* HP at 29a, ¶ 9.) Consequently, when Capital appealed from the critical-vendors order, it correctly named Kmart as the only other party to the order. *See* Fed. R. Bankr. P. 8001(a)

(notices of appeal in bankruptcy must name "all parties to the judgment, order, or decree appealed from").

Upon the filing of Capital's notice of appeal, the district court assumed jurisdiction over the critical-vendors order and its subject matter. *See* 28 U.S.C. § 158(a). *See also Griggs v. Provident Consumer Disc. Co.*, 459 U.S. 56, 58 (1982) (the filing of a notice of appeal confers jurisdiction on the appellate court and divests the lower court of its control over those aspects of the case involved in the appeal). Like the bankruptcy court, the district court did not require personal jurisdiction over Handleman because it did not determine any personal claim by or against Handleman. Rather, it reviewed the propriety of the critical-vendors order and its grant of authority to Kmart to use its property for the payment of certain prepetition claims prior to plan confirmation. Since the district court's jurisdiction, like the bankruptcy court's, was "premised on the res, not on the persona," its exercise was nonetheless binding on Handleman and all other Kmart creditors, "whether named in the action or not." *See Hood*, 124 S. Ct. at 1911.[5]

[5] In a separate adversary proceeding, reorganized Kmart has sought affirmative relief against Handleman to recover the payment that it received under the authority of the critical-vendors order. (*See* HP at 10.) Therefore, in contrast to the critical-vendors order and its subsequent reversal, any judgment in that proceeding *will* require the exercise of personal jurisdiction over Handleman because the judgment will be premised on the persona and not on the res. *Cf. Hood*, 124 S. Ct. at 1911. In the event that reorganized Kmart recovers any funds from Handleman on account of that judgment, Handleman will be entitled to a claim against the Kmart bankruptcy estate to be treated in accordance with Kmart's confirmed chapter 11 plan. *See* 11 U.S.C. § 502(h).

Handleman's primary citations for its jurisdictional argument are inapposite because they involve *in personam* judgments. *See, e.g., Richards v. Jefferson County*, 517 U.S. 793, 798 (1996); *Martin v. Wilks*, 490 U.S. 755, 761-62 (1989); *Helicopteros Nationales De Colombia, S.A. v. Hall*, 466 U.S. 408, 412 (1984). *Richards* and *Martin* certainly emphasize the "principle of general application in Anglo-American jurisprudence that one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party." *Richards*, 517 U.S. at 798; *Martin*, 490 U.S. at 761. However, they also emphasize an exception to that general principle "where a special remedial scheme exists expressly foreclosing successive litigation by nonlitigants *as for example in bankruptcy*. . . . " *Richards*, 517 U.S. at 798-99 (emphasis added); *Martin*, 490 U.S. at 762 n.2 (emphasis added). *See also Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846 (1999) (acknowledging the same exception). Handleman ignores the bankruptcy exception.

Consequently, Handleman's jurisdictional argument has no merit. No conflict exists between the Decision and this Court's decisions regarding *in personam* judgments because personal jurisdiction is irrelevant in this case. The district court's reversal of the critical-vendors order was an appropriate exercise of *in rem* jurisdiction that is binding on Handleman and all other entities. Handleman's request to be carved out from the binding effect of that reversal is inappropriate and must be denied accordingly.

B. The Seventh Circuit correctly short-circuited Handleman's due process argument because (i) the critical-vendors order granted no rights to Handleman, and (ii) Handleman had no consequent property interest at stake in the district court appeal.

The Handleman Petition misstates the Seventh Circuit's rationale for rejecting Handleman's due process argument. In rejecting Handleman's due process argument, the Seventh Circuit held that (1) Handleman was not a party to the critical-vendors order, (2) neither Handleman nor any other party acquired any rights under the order, and (3) Capital correctly followed Fed. R. Bankr. P. 8001 when it named only Kmart in its notice of appeal from the critical-vendors order. *See Kmart,* 359 F.3d at 870. Instead of addressing the Seventh Circuit's holding, Handleman's Petition focuses upon its dicta,[6] which present nothing for this Court to review. *See Stickel v. United States,* 76 S. Ct. 1067, 1068 (1956). *See also Black v. Cutter Labs.,* 351 U.S. 292, 297 (1956) ("This Court . . . reviews judgments, not statements in opinions.").

Contrary to Handleman's inaccurate contention that the Seventh Circuit "saw no problem with Handleman's Due Process Rights being skipped at the District Court

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[6] Specifically, Handleman complains about the Seventh Circuit's observations that (1) the precedential impact of its Decision has the same practical effect as its preclusive impact, and (2) it permitted Handleman to intervene in the appeal in any event. (HP at 18-22.) Handleman also complains about the Seventh Circuit's admonition that Handleman should have paid more attention to its $49 million stake in the case. (HP at 22-23.) Since these statements could have been deleted from the Decision without seriously impairing the analytical foundation of the Seventh Circuit's holding, they constitute dicta. *See United States v. Crawley,* 837 F.2d 291, 292 (7th Cir. 1988).

stage" (*see* HP at 18), the Seventh Circuit actually found that the critical-vendors order gave no rights to Handleman or any other creditor. *See Kmart,* 359 F.3d at 870. Consequently, Handleman had no due process interest at stake when the district court conducted its appellate review of the critical-vendors order.

The procedural requirements of due process, notice, and an opportunity to be heard apply only to the deprivation of constitutionally protected interests, liberty, and property. The "range of interests protected by procedural due process is not infinite." *Bd. of Regents v. Roth*, 408 U.S. 564, 569-70 (1972) (a college professor with a one-year contract had no constitutionally protected interest requiring due process, notice, and hearing before his contract was not renewed). Handleman acquired no interest from the critical-vendors order that was entitled to due process protection. (*See* HP at 29a, ¶ 9 ("nothing contained herein shall create, nor is it intended to create, any rights in favor of, or enhance the status of any claim held by, any person").[7] Consequently, Handleman's due process argument, like Professor Roth's, was appropriately rejected. *See Roth*, 408 U.S. at 569-70.

Moreover, as the Seventh Circuit noted, Handleman received better notice and a better opportunity to be heard with respect to Kmart's critical-vendors motion than Capital and most of Kmart's other creditors. *Kmart,* 359

[7] Handleman erroneously contends that both the critical-vendors order and Kmart's underlying motion identified Handleman "as having a 'particularized interest' in the matter." (*See* HP at 7.) Contrary to Handleman's contentions, neither the critical-vendors order nor the underlying motion contain any such language. (*See* HP at 24a-32a; IP at 45a-63a.)

F.3d at 870. *See also Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950) (The right to be heard has worth when "one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest."). Handleman, however, chose neither to participate as a litigant in the bankruptcy court, file an appearance, intervene pursuant to Fed. R. Bankr. P. 2018, nor seek notice pursuant to the case management order entered in Kmart's bankruptcy case. Kmart, as the movant, and Capital, as the sole objector, were the only parties to the contested matter surrounding Kmart's critical-vendors motion. *See* Fed. R. Bankr. P. 9014. Consequently, Handleman did not become a party to the critical-vendors order, and it therefore was not entitled to notice of Captial's subsequent appeal. *See* Fed. R. Bankr. P. 8001.

The authority relied upon by Handleman to support its due process argument is easily distinguished from this case. Unlike the numerous cases cited by Handleman, the district court's order of reversal did not strip or bar any liens, claims, or other property interests Handleman may have had with respect to Kmart or its estate. *Cf., e.g., Tulsa Prof'l Collection Servs. v. Pope*, 485 U.S. 478, 488-89 (1985) (creditor's claim barred in probate case); *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 792-95 (1983) (mortgagee's property interest foreclosed through tax sale); *Armstrong v. Manzo*, 380 U.S. 545, 550 (1965) (deprivation of parental rights); *Mullane*, 339 U.S. at 320 (two types of claims barred by trust accounting proceeding); *City of N.Y v. N.Y, N.H. & H.R. Co.*, 344 U.S. 293, 297 (1953) (involving the loss of a tax lien claim).[8]

[8] Handleman's reliance on *City of N.Y.* in support of its due process arguments is also misplaced because that case was decided on statutory rather than constitutional grounds. *See GAC Enters., Inc. v. Medaglia*

(Continued on following page)

Moreover, as stated above, the reversal of the critical-vendors order resolved no personal claim or affirmative relief by or against Handleman. *Cf., e.g., Nelson v. Adams USA, Inc.*, 529 U.S. 460, 463-64 (2000) (involving personal liability for costs and attorneys' fees); *Ortiz*, 527 U.S. at 821 (mandatory class action aggregating damages claims). By reversing the critical-vendors order, the district court merely clarified the bankruptcy court's lack of authority to allow Kmart to pay the prepetition claims of their trade creditors under the doctrine of necessity or § 105(a). (HP at 16a-19a.) It entered no *in personam* relief for or against Handleman or any other creditor. As a result, Handleman's due process argument has no merit, and the Seventh Circuit appropriately rejected the argument.

III. Irving's Petition Seeks An Advisory Opinion On The Scope Of § 364(e).

Irving's Petition proceeds from the mistaken premise that § 364 of the Bankruptcy Code formed a basis for the bankruptcy court's critical-vendors order. Notwithstanding Irving's constant assertions to that effect, however, § 364 formed absolutely no basis for the entry of the order. (*See* IP at 29a-35a.) The plain meaning of the order and the absence of any reference to § 364 in the record refute Irving's assertions. Regardless of whether a circuit split exists on the scope of § 364(e), as Irving asserts in its Petition, the resolution of that split is irrelevant to this case.

(In re Medaglia), 52 F.3d 451, 455-57 (2d Cir. 1995); *Grossie v. Sam (In re Sam)*, 894 F.2d 778, 781 (5th Cir. 1990).

The express purpose of the critical-vendors order was the payment of prepetition trade claims, not the incurrence of postpetition trade credit. Entitled "Order Under 11 U.S.C. § 105(a) Authorizing The Payment Of Prepetition Claims Of Certain Critical Trade Vendors," the critical-vendors order stated that the "Debtors are authorized, but not directed, in the reasonable exercise of their business judgment, to pay all, a portion or none of the prepetition claims" of so-called critical vendors. (IP at 29a-30a.) Though the order instructed Kmart to pursue "customary trade terms" in exchange for critical-vendor payments, its authorized discretion to make those payments was not conditioned upon the receipt of postpetition trade credit. (IP at 31a-33a.)

The sole statutory basis expressed for the critical-vendors order was § 105. (IP at 29a.) The order did not mention § 364. (*Id.*) Moreover, the record shows that (1) Kmart's critical-vendors motion neither raised nor mentioned § 364 (IP at 47a ("[t]he statutory predicates for the relief sought herein are section 105(a) of the Bankruptcy Code")), and (2) neither Kmart nor any other party presented testimony or other evidence at the bankruptcy court's hearing on the critical-vendors motion to establish grounds for relief under § 364.[9] (KP at 44a-75a.) Capital, therefore, had no reason or opportunity to cross-examine witnesses, rebut testimony, or contest any fact or argument

[9] After presenting its critical-vendors motion to the bankruptcy court at the "first-day" hearing of its bankruptcy case, Kmart presented its motion ("DIP Financing Motion") for authority to obtain $2 billion in postpetition financing pursuant to §§ 105, 361, 362, 364(c)(2), and 364(c)(3). Kmart presented evidence and testimony to establish the grounds for relief under § 364 *specific* to the DIP Financing Motion but only *after* the bankruptcy court had entered the critical-vendors order.

relating to § 364 with respect to the critical-vendors motion. As a result, neither the bankruptcy court nor the district court were given any opportunity to rule on any issue under § 364 in connection with the critical-vendors order.

Irving's Petition is based upon a circuit split over the proper application of § 364(e) to bankruptcy financing orders that permit "cross-collateralization." Except for the Decision, however, the decisions that Irving cites in support of its contention involve bankruptcy financing orders that were entered under the auspices of § 364. (*See* IP at 9-12 (comparing (i) *In re Adams Apple, Inc.*, 829 F.2d 1484, 1488 (9th Cir. 1987) and *Unsecured Creditors' Comm. v. First Nat'l Bank & Trust Co. of Escanaba (In re Ellingsen MacLean Oil Co., Inc.)*, 834 F.2d 599, 604 (6th Cir. 1987); (ii) *Shapiro v. Saybrook Mfg. Co. (In re Saybrook Mfg. Co.)*, 963 F.2d 1490, 1493 (11th Cir. 1992); and (iii) *Resolution Trust Corp. v. Swedeland Dev. Group, Inc. (In re Swedeland Dev. Group, Inc.)*, 16 F.3d 552, 562 (3d Cir. 1994)).)

None of the decisions that Irving cites involved the extension of § 364(e) to an order entered under a provision of the Bankruptcy Code other than § 364. *Id.* In fact, the U.S. Court of Appeals for the Ninth Circuit ("Ninth Circuit") later clarified and distinguished its earlier decision in *Adams Apple* by holding that financing orders entered under a section of the Bankruptcy Code other than § 364 are not shielded from appeal by virtue of § 364(e). *See Transamerica Commercial Fin. Corp. v. Citibank, N.A. (In re Sun Runner Marine, Inc.)*, 945 F.2d 1089, 1095 (9th Cir. 1991) (finding *Adams Apple* to be inapplicable because the underlying bankruptcy court order was entered under § 365, not § 364).

Like the Ninth Circuit in *Sun Runner*, the Seventh Circuit correctly concluded that the mootness provisions of § 364(e) did not apply to the critical-vendors order. *See Kmart*, 359 F.3d at 869. Contrary to Irving's contention that the Seventh Circuit "concluded that the protections of section 364(e) do not apply because the bankruptcy court's approval of the [critical-vendors order] was erroneous" (IP at 21), the Seventh Circuit actually and correctly determined that § 364(e) is irrelevant because the critical-vendors order was not a § 364 financing order. *See Kmart*, 359 F.3d at 869. The Seventh Circuit refused to "invent missing language" in the Bankruptcy Code to shelter the critical-vendors order from appeal. *Id.*

Section 364(e) is inapplicable to the critical-vendors order for at least two reasons.[10] First, the plain language of § 364(e) only shelters bankruptcy court authorizations "*under this section* to obtain credit or incur debt, or of a grant under this section of a priority or a lien . . . [or] the validity of any debt so incurred, or any priority or lien so granted. . . ." 11 U.S.C. § 364(e) (emphasis added); *Saybrook*,

[10] The reasoning of the Seventh Circuit's decision in *In re EDC Holding Co.*, 676 F.2d 945, 948 (7th Cir. 1982) provides an additional reason for the inapplicability of § 364(e) to the critical-vendors order. In *EDC Holding*, the Seventh Circuit held that § 364(e) would not moot an appeal where the underlying credit transaction evidently effected an improper purpose under the Bankruptcy Code. *EDC Holding*, 676 F.2d at 948. The use of § 364 to pay prepetition unsecured claims is improper because such payments (i) are not authorized under the plain terms of § 364, and (ii) are contrary to the fundamental priority scheme of the Code. *See Saybrook*, 963 F.2d at 1494-95. *See also Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1356 (7th Cir. 1990) (Section 364 orders "do not allow a creditor to boost the priority of existing loans."). Consequently, § 364(e) does not shield such payments from subsequent appeals. *See Saybrook*, 963 F.2d at 1494-95; *EDC Holding*, 676 F.2d at 948.

963 F.2d at 1493; *Sun Runner*, 945 F.2d at 1095. As explained above, Kmart's critical-vendors motion sought no authority either to incur debt or grant a priority or a lien under § 364; it only sought leave to *pay* prepetition debts under § 105(a). (*See* IP at 45a-46a.) Furthermore, Capital's subsequent appeal did not affect the "validity of any debt" or "any priority . . . granted . . . " to Irving as a result of Kmart's critical-vendors motion because, as the Seventh Circuit noted in its Decision, (1) "*no* creditor acquired rights" in the critical-vendors order (IP at 35a, ¶ 9 ("nothing herein shall create . . . any rights in favor of, or enhance the status of any claim held by, any person")), and (2) critical vendors such as Irving "have been paid in full for post-petition goods and services." *Kmart*, 359 F.3d at 870. Consequently, on its face, § 364(e) cannot apply to the critical-vendors order. *See Saybrook*, 963 F.2d at 1493; *Sun Runner*, 945 F.2d 1095.

Second, § 364(e) only protects the validity of any debt or the priority of any lien granted under § 364 to an "entity that extended such credit in *good faith*. . . . " 11 U.S.C. § 364(e) (emphasis added). Because Kmart's critical-vendors motion was not brought under § 364, however, the critical-vendors order lacked the support of any findings that Kmart, Irving, or any of the other vendors were acting in good faith as § 364(e) requires. *See N.Y. Life Ins. v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 901 F.2d 1359, 1367 (6th Cir. 1990) (holding that "an implicit finding of 'good faith' in a § 364(e) context is insufficient and that 'good faith' under that section should not be presumed"); *see also In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143,

148-49 (3d Cir. 1986) (to the same effect in a case under § 363(m)). Irving's good faith cannot be presumed.[11]

Moreover, Irving's good faith is belied to the extent that its insistence on the payment of its prepetition claims violated the automatic stay. *See* 11 U.S.C. § 362. *See also EDC Holding*, 676 F.2d at 948 (a creditor fails to act in good faith if it acts for an improper purpose). If, as Kmart alleged in support of its critical-vendors motion (IP at 57a, ¶ 27) and as Irving appears to confirm in its Petition,[12] the critical vendors were leveraging their refusal to deal with Kmart on a postpetition basis in order to collect their prepetition debts, then those creditors were violating the automatic stay arising from Kmart's bankruptcy filing by virtue of § 362(a). *Sportfame of Ohio, Inc. v. Wilson Sporting Goods Co. (In re Sportfame of Ohio, Inc.)*, 40 B.R. 47, 50 (Bankr. N.D. Ohio 1984) (refusal to ship goods to coerce payment of prepetition debt violates § 362(a)(6)). *Accord Lansdale Family Rests., Inc. v. Weis Food Serv. (In re Lansdale Family Rests., Inc.)*, 977 F.2d 826, 829 (3d Cir. 1992) (application of postpetition payment to prepetition debt violates § 362(a)(3)); *Andrews Univ. v. Merchant (In re Merchant)*, 958 F.2d 738, 741-42 (6th Cir. 1992) (the refusal to issue a transcript until a debtor pays a prepetition debt

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[11] Irving contends that its good faith is not an issue because the record below shows "no indication that Irving extended credit in bad faith." (IP at 22.) However, that contention ignores the fact that the record below contained no findings of good faith because Kmart did not seek the entry of the critical-vendors order pursuant to § 364. Moreover, Irving erroneously implies that it is entitled to a presumption of good faith that must be rebutted by evidence of bad faith.

[12] Irving readily admits that "unpaid vendors often raise their prices on post-petition shipments to recoup pre-petition losses from bankrupt debtors if they have the leverage to do so, and sophisticated debtors, such as Kmart, are aware of this." (IP at 27.)

violates § 362(a)(6)). Thus, either Irving and the other critical vendors were violating the automatic stay and acting in bad faith in leveraging the payment of prepetition debts through the critical-vendors order, or the alleged factual predicate of Kmart's critical-vendors motion was a fabrication. Either way, Irving is not entitled to the protections of § 364(e).

The Irving Petition, at its essence, constitutes a request for an advisory opinion from this Court on the split that exists between the circuits over the application of § 364(e) to bankruptcy financing orders that allow the cross-collateralization of a creditor's prepetition debt. That circuit split is a purely academic question in the context of this case because the critical-vendors order was not entered or authorized under § 364, which means that § 364(e) is inapplicable on its face. Therefore, even if Irving was successful in convincing this Court to resolve the circuit split, the subsequent resolution would not solve Irving's problem. The shelter of § 364(e) would not extend to the § 105 critical-vendors order in any event. *See Sun Runner*, 945 F.2d at 1095.

This Court does not render advisory opinions; it only resolves concrete controversies. *See, e.g., Diamond v. Charles*, 476 U.S. 54, 61-62 (1986); *Ashcroft v. Mattis*, 431 U.S. 171, 172-73 (1977); *Ruth v. Delano*, 338 U.S. 226, 231 (1949). Irving's Petition should be denied accordingly.

CONCLUSION

For the foregoing reasons, the Petitions for a writ of certiorari from this Court to the Seventh Circuit should be denied.

Respectfully submitted,

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